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No. 574

In the Supreme Court of the United States

OCTOBER TERM, 1958

HAROLD M. KOCH, BESSIE KOCH, WILLIAM L. KOCH, ROSE KOCH, REBECCA KOCH ABEL, MAURICE P. KOCH and DAISY KOCH, PETITIONERS

v.

UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 6-12) are not officially reported. The opinion of the Court of Appeals (Pet. viii-xvi) is not yet reported.

JURISDICTION

The judgment of the Court of Appeals was entered on September 12, 1958. (Pet. xviii.) A petition for rehearing was denied on October 27, 1958 (Pet.

xvii), and the petition for a writ of certiorari was filed on December 11, 1958. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether the record supports the concurrent findings that the taxpayers were not in the business of financing motion-picture ventures in the year 1947 and hence could not claim a business loss on that premise.

2. Whether the Court of Appeals properly rejected taxpayers' attack upon various instructions given the jury.

STATUTE AND RULE INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; * * *

* * * *

(k) [As amended by Sec. 124(a), Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 113 (a), Revenue Act of 1943, c. 63, 58 Stat. 21] *Bad Debts.*—

(1) *General Rule.*—Debts which become worthless within the taxable year; or (in

the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. * * *. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection.

* * * * *

(4) *Non-business debts.*—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23 (e) and (k).)

Federal Rules of Civil Procedure:

Rule 51. *Instructions to Jury: Objection.* * * *. No party may assign as error the giving or the failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection. * * *.

STATEMENT

The pertinent facts, as found by the District Court (R. 7-11) and the jury (R. 7), and as adopted by the Court of Appeals (Pet. viii-xi), may be summarized as follows:

The taxpayers are members of a partnership which they entered into pursuant to a written agreement executed on December 31, 1941. The firm name is H. Koch & Sons. (R. 7-8.)

The written article of co-partnership of December 31, 1941, provided that the taxpayers would engage in the sole business of manufacturing luggage. The partnership agreement was amended on October 23, 1944, so as to allow the taxpayers to engage also in the business of financing motion-picture productions. This amendment was necessary in order to overcome the provisions in the original agreement which required the taxpayers to devote all of their time to the luggage manufacturing business. The taxpayers, however, during the years 1945 through 1947, continued in the luggage business. (R. 8; Pet. iv.)

In 1946 the taxpayers, through the partnership, advanced $90,000 to Beacon Pictures Corporation to enable it to produce one motion picture. The motion picture was not successful and the debt became worthless in 1947. (R. 8-9; Pet. ix.)

Subsequently, the taxpayers, through the partnership, engaged in other negotiations for loans but none materialized. Maurice P. Koch, one of the taxpayers, was an officer and stockholder of Ambassador Productions, Inc., and Producers Finance Corporation,

and was active in their affairs. One of the corporations, Ambassador Productions, purchased rights to the book "Hill of the Hawk," but no picture was produced. (R. 167, 202-203; Pet. xi.)

The partnership, H. Koch & Sons, and the taxpayers filed income tax returns for the years 1945 and 1947. These returns were amended to claim business losses for the year 1947 and net operating loss carry-backs for the year 1945, alleged to have arisen from the loss of $90,000 on the loan to Beacon Pictures. Maurice P. Koch and his wife claimed that $15,000 of the loss was theirs but that the remaining $75,000 of the loss is to be allocated among all the taxpayers as partners of H. Koch & Sons. The claims for refund for the years 1945 and 1947 were denied on the ground that the claimed loss was allowable as a non-business bad-debt loss deduction only. (R. 9-10; Pet. ix.)

Subsequently, the taxpayers brought this action in the District Court for refund of taxes and demanded a jury trial, which was granted. (R. 3, 8; Pet. ix.) The District Court directed a verdict against Maurice P. Koch and his wife for their claim to a business loss deduction based upon the $15,000 loss chargeable to them. (R. 14; Pet. x.)

It was stipulated that the taxpayers' right to recover the alleged overpayments of taxes would require the jury to answer "yes" to the following interrogatory submitted to them (R. 10):

> During the year 1947, was H. Koch & Sons regularly engaged in the business of financing motion picture ventures?

The jury answered this question "No." (R. 14.) Thereafter, also under stipulation, the District Court entered findings of fact, including the special verdict, and conclusions of law, finding that the claimed losses were deductible as non-business bad-debt losses only (R. 7-12), and entered judgment for the Government (R. 13-15). The Court of Appeals affirmed. (Pet. xvi.)

ARGUMENT

1. Section 23(k)(1) of the Internal Revenue Code of 1939, *supra*, pp. 2-3, authorizes the deduction in full of a debt which becomes worthless during the taxable year, but excepts therefrom non-business debts of non-corporate taxpayers. Section 23(k)(4) of the 1939 Code, *supra*, p. 3, allows a deduction for a non-business debt when the debt becomes worthless in the taxable year, limiting the deduction to a short-term capital loss deduction. In determining whether a debt is business or non-business, the inquiry is whether the loss was incurred in the conduct of a trade or business in which the taxpayer was personally engaged at the time the debt became worthless. *Skarda* v. *Commissioner*, 250 F. 2d 429, 435 (C.A.10th); *Rokress* v. *Commissioner*, 234 F. 2d 146, 150 (C.A.5th); *Hickerson* v. *Commissioner*, 229 F. 2d 631, 634-635 (C.A.2d).

The taxpayers, contending that they were in the business of financing motion-picture ventures, claim the right to a business deduction as the result of the loss incurred when the debt owed them by Beacon Pictures Corporation became worthless in 1947.

(Pet. ix.)[1] The courts below rejected this claim and found that the loss was deductible as a non-business bad debt only. (R. 11-12; Pet. x-xvi.)

The taxpayers argue (Pet. 14-15) that the courts below erred in going outside their partnership agreement to determine whether in fact they were carrying on the business of financing motion-picture ventures during the year 1947. In their view, since the partnership agreement provided that the taxpayers would engage in that business, the jury was not authorized to find otherwise.

But the question whether a taxpayer's activities constitute a trade or business is, as the Court of Appeals held (Pet. xii), one of fact, and an examination of the entire record is necessary in each case. *Higgins* v. *Commissioner*, 312 U.S. 212, 217. The activities of the taxpayer—whether they are extensive, continu-

[1] Although the taxpayers also claimed the loss as a business loss under Section 23(e)(1) of the 1939 Code, *supra*, p. 2 (Pet. ix), since the courts below found that the transaction in question constituted a loan (R. 8-9; Pet. ix), any deduction would have to be taken under Section 23(k), the bad-debt loss provision, or not at all. *Putnam* v. *Commissioner*, 224 F. 2d 947 (C.A.8th), affirmed, 352 U.S. 82; *Spring City Co.* v. *Commissioner*, 292 U. S. 182. It should be noted, however, that the test used to determine whether a taxpayer's loss was incurred in a trade or business under Section 23(k)(1) and (4) is the same test as that used to determine that question under Section 23(e)(1), *supra*, p. 2. *Holtz* v. *Commissioner*, 256 F. 2d 865 (C.A.9th); *Commissioner* v. *Smith*, 203 F. 2d 310, 311 (C.A.2d), certiorari denied, 346 U.S. 816; H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 76-77 (1942-2 Cum. Bull. 372, 431); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 90 (1942-2 Cum. Bull. 504, 573).

ous and regular or isolated and irregular—must be taken into consideration. *Burnet* v. *Clark*, 287 U.S. 410, 414; *Dalton* v. *Bowers*, 287 U.S. 404, 409. The existence or non-existence of an agreement to engage in a particular business is merely one factor to consider along with all the other evidence. In this case, the jury found, upon consideration of the oral testimony and documentary evidence, that the taxpayers (through their partnership) were not regularly engaged in the business of financing motion-picture ventures during the year 1947 (R. 14), and the District Court accordingly decided that the debt, which became worthless in 1947, was a non-business debt. (R. 11-12). The Court of Appeals affirmed the jury's verdict and the trial court's findings as being sustained by substantial evidence. (Pet. xv.) The concurrent findings of the jury and of the two courts below are entitled to finality here. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51; *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.[2]

2. Taxpayers argue (Pet. 16-17) that the court below erroneously held that a jury, in determining whether a trade or business exists, is limited to a consideration of concluded transactions and may not take negotiations into account. The Court of Appeals did not so hold and the jury was not in fact so restricted.

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[2] Since the loss was not incurred in the operation of a trade or business of the taxpayers, it did not give rise to a net operating loss carry-back to the year 1945. Section 122(d)(5) of the Internal Revenue Code of 1939, as added by Section 211(b) of the Revenue Act of 1939, c. 247, 53 Stat. 862 (26 U.S.C. 1952 ed., Sec. 122(d)(5)).

The question before the Court of Appeals (Pet. xiv) was whether the trial court erred in not specifically instructing the jury, as requested by the taxpayers, that the jury should consider attempts by the taxpayers to negotiate for and enter into financial transactions, though those attempts were futile. Although the District Court did not instruct the jury in the language requested (R. 25-26), it did admonish the jury that they were to consider *all* the evidence that was admitted in the case (R. 299-300).[3] The taxpayers' request was, therefore, adequately covered, as the Court of Appeals stated (Pet. xiv).

Taxpayers also suggest (Pet. 12-13) that the court below incorrectly ruled that, in the contemplation of the revenue statutes, there cannot be a trade or business consisting of the financing of motion-picture ventures. But the Court of Appeals merely speculated (Pet. xv) that the jury may have taken a com-

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[3] The District Court instructed the jury in part as follows (R. 300-301, 302):

> Isolated or infrequent transactions of a taxpayer in any field do not constitute a trade or business within the meaning of the Internal Revenue Code.
>
> In determining whether an activity of a taxpayer is a trade or business you should consider among other things how extensive was the activity * * * whether it was regularly carried on, and whether the activity occupied a substantial portion of the time, energy and effort of the taxpayer.
>
> * * * *
>
> In determining whether any issue has been proven by a preponderance of evidence you should consider all of the evidence bearing either way upon the question * * *.

See, also, R. 297-299.

mon-sense view of the facts in this particular record and refused to recognize the investments as constituting a trade or business. See *Higgins* v. *Commissioner*, 312 U.S. 212, 218; *Burnet* v. *Clark*, 287 U.S. 410; *Dalton* v. *Bowers*, 287 U.S. 404; *Commissioner* v. *Smith*, 203 F. 2d 310 (C.A.2d), certiorari denied, 346 U.S. 816. The court certainly did not express an opinion or rule that financing activities can in no event constitute a trade or business. Indeed, this case was tried to the jury under instructions that one may be in the trade or business of financing motion pictures within the meaning of the taxing statute (R. 298-301), and the Court of Appeals likewise considered the case in that posture (Pet. x, xii-xv).

Finally, taxpayers object to a portion of the charge to which they took no exception at the trial. The claim is that one of the instructions given placed too much weight on the presumption that the Commissioner's administrative determination is correct, and that it suggested to the jury that the presumption was itself evidence.[4] As the Court of Appeals noted, how-

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[4] The instruction (R. 301-302) was as follows:

> The burden of proof in this case is upon the plaintiffs to prove by a preponderance of evidence that the loan by plaintiffs to the Beacon Pictures Corporation was a loan made in plaintiffs' regular trade or business. There is a presumption that the determination by the Commissioner of Internal Revenue that the plaintiffs were not engaged in the trade or business of financing motion pictures is correct. The burden is upon the plaintiff to overcome the presumption of the correctness of the Commissioner's determination by proving by a pre-

ever (Pet. xvi), the instruction "did not specifically state that the presumption was to be considered as evidence, and the burden of proof of * * * [taxpayers] was correctly explained." Certainly, if taxpayers were of the view that the niceties of explaining a presumption to a jury might have been better served by some other formulation, they owed it to the court to make it known that they had some objection to the instruction given. Rule 51, Federal Rules of Civil Procedure. The Court of Appeals was fully warranted in treating them as precluded on this point.[5]

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ponderance of evidence that they were engaged in the trade or business of financing motion pictures.

By a preponderance of evidence is meant such evidence as when weighed with that opposed to it has more convincing force, and from which it results that the greater probability is in favor of the party upon which the burden rests. Preponderance of evidence means not the greater number of witnesses but the greater weight, probability, quality and a convincing effect of the evidence and proof offered by the party holding the affirmative as compared with any opposing evidence. If the scales of proof hang evenly the verdict should be against the party who has the burden of proof.

In determining whether any issue has been proven by a preponderance of evidence you should consider all of the evidence bearing either way upon the question, regardless of who produced it. A party is entitled to the same benefit from evidence that favors his cause or defense when produced by his adversary as when produced by himself.

[5] The opinion of the Court of Appeals nowise suggests that the court would not notice "plain error"; it holds simply that "plain error" was not shown.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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